



Bay Area Water Supply & Conservation Agency

July 31, 2006

The Honorable Jose Esteves, Mayor
City of Milpitas
455 East Calaveras Blvd.
Milpitas, CA 95055

**Re: Negotiation of Agreement with San Francisco to Provide Its Regional Customers
a Reliable Supply of High Quality Water at a Fair Price**

Dear Mayor Esteves:

The City of Milpitas is one of the 28 members of the Bay Area Water Supply and Conservation Agency (BAWSCA), whose board I have the honor to chair. In the early 1980s, the Bay Area Water Users Association (BAWUA), the voluntary coalition of the regional wholesale customers of San Francisco, took the lead in the negotiations which led to the 1984 Master Water Sales Contract between all BAWSCA agencies and San Francisco. This master agreement, under which our cities and water districts receive Hetch Hetchy water, is the result of those negotiations. Now, as you may know, the 1984 Master Contract will expire, after 25 years, in June 2009.

BAWSCA is the legal and political successor to BAWUA. BAWSCA's governing board is comprised primarily of elected officials from each member agency. Member agencies have expressed a desire for BAWSCA to play a similar role (as in the 80's) in negotiations for the new agreement with San Francisco. BAWSCA is ready to do so, as described in the accompanying attachment. We'll provide this service to all member agencies which so request and which provide the necessary authorization through adoption of a resolution along the lines of the enclosed sample. While BAWSCA will provide a strong central voice in negotiating the new master agreement with San Francisco, final signature authority will remain with each member agency.

BAWSCA would like to begin discussions/negotiations with San Francisco soon after the Program Environmental Impact Report on the \$4.3 billion Water System Improvement Program is released in draft. That's expected to happen in November of this year. Therefore, it would be most helpful to receive all authorizations by the end of September.

We hope Milpitas will enact an authorizing resolution promptly. If you have any questions, please call Art Jensen, BAWSCA's General Manager, at (650) 349-3000.

Cordially,

A handwritten signature in black ink that reads "Ben Beecham". The signature is written in a cursive, flowing style.

Bern Beecham
Chair

Enclosures

cc: Mr. Charlie Lawson, City Manager
Mr. Robert Livengood, BAWSCA Board Member

**Attachment to July 28, 2006 letter
from Bern Beecham on
Negotiation of an Agreement for San Francisco to
Provide Its Regional Customers With a Reliable
Supply of High Quality Water at a Fair Price**

This attachment has two purposes. The first is to convey BAWSCA's readiness to represent all of its member agencies in negotiations with San Francisco for the terms on which San Francisco will deliver, and BAWSCA agencies will purchase, water after the 1984 Settlement Agreement and Master Water Sales Contract expires in mid-2009. The goal will be a new, or extended, agreement with San Francisco for a reliable supply of high quality water at a fair price. The second purpose is to request that the governing board of each agency which wants BAWSCA to serve in this capacity take formal action to establish BAWSCA's authority, and responsibility, to act on its behalf by adopting a resolution substantially along the lines of the sample attached. This attachment provides background and specifics about this action.

The first part of the attachment provides background on the existing contract and some of the context in which negotiations for the future agreement will take place. It then describes BAWSCA's formation and recent activities, as well as summarizing the respective roles that BAWSCA and its member agencies could each logically play in negotiations. The third section describes BAWSCA's capabilities in terms of a multi-disciplinary negotiating "team".

The fourth section outlines in brief and general terms the overall objectives that BAWSCA would seek to accomplish in the negotiations, based on the interests that member agencies have themselves articulated in a consultative process with BAWSCA over the past year.

The final section addresses the mechanics of each agency delegating the necessary authority to BAWSCA, as well as the approximate schedule for beginning discussions with San Francisco. A sample resolution appointing BAWSCA as your agency's representative is attached.

1. EXISTING WATER CONTRACTS WILL EXPIRE IN JULY, 2009

The Settlement Agreement and Master Water Sales Contract signed in 1984 by San Francisco and all wholesale customer agencies will expire on June 30, 2009. (Its title reflects the fact that the 1984 contract settled a federal court lawsuit, brought by wholesale agencies, challenging San Francisco water rates.) The individual water supply contracts for all but two of the agencies also expire in June 2009.

The contracts are expiring at a time of change and uncertainty. San Francisco faces a challenge of unprecedented scale - rebuilding and improving the regional water system after decades of deferred maintenance to standards designed to withstand major earthquakes on the three faults that lie beneath the system's dams, pipelines, and treatment plants. A top priority for all residents, businesses and community organizations of the four-county service area is for San

San Francisco to complete this vital Water System Improvement Program (WSIP), on time (by 2014) and on budget (\$4.3 billion).

At the same time, there are also unprecedented challenges to increasing diversions of water from the Tuolumne River. The river is the obvious choice for obtaining at least the majority of the additional water projected to be needed by BAWSCA agencies from the San Francisco system in 2030. San Francisco has the necessary water rights, the water is of extremely high quality, and the cost of sizing facilities to allow for wholesale customer demand to be met from the Tuolumne River is small in comparison to the rest of the \$4.3 billion capital program and in comparison to most alternatives. Environmental organizations based both in the Tuolumne River watershed and in the Bay Area are generally opposed to taking any more water from the river.

The Federal Energy Regulatory Commission (FERC) license for New Don Pedro Reservoir (where San Francisco has a substantial “water bank”) expires in 2012. It is likely that FERC will be urged to require more water be left in the river, rather than less. Moreover, the California Department of Water Resources has just recently released a report evaluating the feasibility of removing O’Shaughnessy Dam and draining Hetch Hetchy Reservoir.

San Francisco has not yet made any firm commitments to meeting the increased demand in the wholesale service area, which is projected to occur by 2030 even after cost-effective conservation measures and recycling projects are deployed. The Program Environmental Impact Report (PEIR) on the overall WSIP is expected to be released in draft by the San Francisco Planning Department for public comment this fall. Its release will sharpen the terms of the public debate over water supply alternatives and regional growth in the Bay Area. The resolution of these issues will, of course, profoundly influence the terms of a new or extended agreement expected to be in effect from 2009 through 2030. For example, San Francisco has indicated that it will use the negotiations to seek commitments from wholesale agencies to implement even more aggressive conservation and recycling measures, irrespective of cost-benefit considerations.

The multi-billion cost of the WSIP will also affect negotiations for a new agreement. Continued application of the cost allocation principles embedded in the current contract would result in a nearly 300% increase in wholesale water rates by 2015. And San Francisco has indicated that it may seek changes to the financial provisions of the Master Contract. One such change that has been mentioned would require wholesale agencies to contribute more quickly to the cost of capital projects, by sharing in debt service as soon as bonds are issued rather than waiting until projects are completed and placed into service.

We expect that the discussions and negotiations leading to a new agreement will be complex and technical as regards both the water supply and the financial provisions.

2. BAWSCA'S ROLE AS REPRESENTATIVE OF WHOLESALE WATER CUSTOMERS

BAWSCA was formed in the Spring of 2003 by unanimous decisions of the governing bodies of city and special district members. The State law that authorized BAWSCA's formation was enacted in 2002, one of three landmark pieces of legislation supported by the Bay Area Water Users Association (the non-profit corporation that preceded BAWSCA and that played a leading role in the negotiations that culminated in the 1984 water sales contract). These bills were supported by the cities, water districts and other water suppliers now represented on BAWSCA's board of directors and were voted for by the overwhelming majority of State legislators.

For the past two years, BAWSCA has focused its attention primarily on the rebuilding and improving of the San Francisco regional system. This has entailed closely tracking San Francisco's major, year-long process of revisions to facilities, construction schedule and cost of the WSIP, including active involvement with the review of those revisions by the California Department of Health Services and the California Seismic Safety Commission, which concluded just a few months ago. It has also meant playing an assertive, constructive role in the lengthy PEIR process, in the development of accurate forecasts of water demand in 2020 and 2030 that underlie basic decisions about the San Francisco system's capacity, and in analyses of the economic effects of water shortages on industries in the BAWSCA service area. In addition, BAWSCA has continued to offer an array of cost-effective water conservation programs to member agencies on a voluntary subscription basis, to monitor San Francisco's compliance with the cost-allocation rules of the existing Master Contract, and to enforce compliance with them through discussions with San Francisco whenever possible and through arbitration when necessary.

More recently, anticipating requests from member agencies to take a leading role in the negotiations for a new agreement, BAWSCA staff have been meeting with representatives of all member agencies. The purpose of these meetings has been to learn the perspectives of member agencies on how the existing contract has worked and what they would like to see continued, or changed, in their relationship with San Francisco after 2009.

These meetings included: (1) an individual meeting with each agency's City Manager/General Manager or their designee; (2) a series of small group meetings with the agencies' designated representatives, held between January and May of this year; and (3) a meeting with all agencies' representatives held in June to review the input we had received through the small group meetings.

One of the important facts we learned from this extensive consultation is that there is a general expectation and desire for BAWSCA to take the lead in negotiating the "global" issues common to all agencies and on which those agencies have similar interests. These issues include: water supply reliability; water quality; cost allocation (as between San Francisco and its wholesale customers); efficient contract administration; and increased collaboration -- rather than

confrontation -- with San Francisco on regional water matters whenever appropriate and possible. There was also broad recognition that most agencies do not have independent resources sufficient to address these "global" issues as effectively as can be done through a pooled effort.

A clear understanding emerged from these meetings in terms of the respective roles of BAWSCA and individual member agencies in the negotiation process.

First, BAWSCA should assume responsibility for negotiating the "global" issues, which apply to the overall relationship between San Francisco and wholesale customers collectively. (Some of these issues are those addressed in the 1984 "Master Contract" signed by San Francisco and all wholesale agencies.)

Second, the ultimate decision on whether or not to accept the resolution of the "global" issues in a proposed new agreement is up to the governing body of each BAWSCA member agency.

Third, individual BAWSCA agencies will have the principal responsibility for negotiating the separate (and much shorter and simpler) individual water supply contracts which address matters unique to each agency such as service area, points of connection between the San Francisco transmission system and the retail system, minimum purchase requirements for those agencies with multiple suppliers, etc. Those individual contracts will most likely not be addressed until negotiation of the new overall agreement is nearing completion.

3. BAWSCA'S CAPABILITIES

BAWSCA has a very strong, in-house staff and has also assembled an equally strong team of consultants in each of the disciplines likely to be called on during negotiations. The negotiations would be led by BAWSCA's General Manager, Art Jensen, who is well-qualified for this task. Art received a Ph.D. in civil engineering from CalTech and has over 30 years of experience in California urban water supply, initially with a major consulting engineering firm, and then as a planner and manager for large Bay Area water utilities, including the San Francisco Water Department and the Contra Costa County Water District. He has served as General Manager of BAWSCA and its predecessor BAWUA since 1995. He is highly regarded in the California water industry.

BAWSCA staff provides Art with capable and experienced support in key areas. Nicole Sandkulla, P.E., is an engineer with relevant experience at East Bay MUD before joining BAWSCA in 1999. John Ummel is thoroughly familiar with the financial provisions of the existing Master Contract, having monitored San Francisco's implementation of it for over 10 years. And Ben Pink brings strong analytical skills to water supply planning issues.

BAWSCA's strong in-house staff is supplemented by capable consultants, some of whom have served BAWSCA, and its predecessor, for many years and are extremely knowledgeable about the San Francisco water system and the Master Contract.

- **Accounting: Burr, Pilger & Mayer, LLP (Steve Mayer and Jeff Pearson).** BPM is a Bay Area-based CPA firm which is currently assisting BAWSCA in reviewing recent compliance audits of San Francisco's implementation of the Master Contract cost allocation and accounting rules. Mr. Mayer and Mr. Pearson have extensive experience in analyzing complex financial transactions and in auditing of California water agencies, respectively.

- **Economics: Energy & Water Economics, Inc. (William Wade, Ph.D.).** Dr. Wade is broadly experienced in natural resource economic analysis. His clients have included major water supply agencies in California and on the East Coast. He has recently assisted BAWSCA in assessing the economic impact of water shortage on Bay Area individual customers.

- **Engineering: Stetson Engineers (Allan Richards, P.E.).** Stetson Engineers is a civil engineering firm that has specialized in water supply for over 30 years. Mr. Richards has assisted BAWSCA (and previously BAWUA) for many years with the complex water use measurement protocols that the Master Contract requires and is thoroughly familiar with the hydraulics of the San Francisco regional system.

- **Municipal Finance: Kelling Northcross Nobriga/Public Resources Advisory Group (David Brodsky).** KNN is a Bay Area-based firm specializing in advising public agencies on financing. PRAG is a similar national firm. David Brodsky, whose background in public finance includes service with cities and a national bond rating agency, has assisted BAWSCA in the analysis of alternative capital cost recovery approaches. KNN has also constructed a computer model that can be used to evaluate various cost allocation proposals.

- **Legal Counsel: Hanson Bridgett Marcus Vlahos & Rudy, LLP (Ray McDevitt).** Hanson Bridgett is a Bay Area-based law firm with a long-standing local government law practice. Ray McDevitt, a senior partner in the firm, participated in the lawsuit against San Francisco that led to the 1984 Master Contract and played a major role in negotiation of that contract. He has served as legal counsel for BAWUA and BAWSCA for many years. Mr. McDevitt can call on other attorneys at Hanson Bridgett with specialized expertise in litigation, environmental law, and municipal finance, including Allison Schutte, who has been assisting BAWSCA staff on a range of issues with the WSIP and associated PEIR.

- **Strategic Counsel: Bud Wendell** is a seasoned public affairs professional with many years of experience in both the public and the private sectors, including Fortune 500 companies and federal, state and local government. He played a central role in the successful effort to secure State legislation requiring San Francisco to repair the water system and establishing BAWSCA.

More recently, he has been instrumental in discussions with San Francisco Mayor Gavin Newsom relating to the WSIP.

BAWSCA's Board has made provision in our FY 2006-2007 budget to support significant activity directed toward agreement negotiations, and I fully expect that it will continue to support the effort to a successful conclusion.

4. BAWSCA AGENCIES' OBJECTIVES

The goals expressed by members can be summarized, at a high level of generality, as seeking an agreement that provides them with a reliable supply of high-quality water at a fair price.

Some of the specific elements that contribute to each of these goals include:

A. Reliable Supply

- Completion of the seismic rehabilitation/WSIP on time and on budget.
- Commitment to good system maintenance practices in the future.
- Equal treatment in delivery of water by San Francisco to customers inside and outside of San Francisco in the event of a major system disruption.
- Management of the system by San Francisco so that generation of hydroelectric power at Hetch Hetchy remains subordinate to providing a reliable water supply to the Bay Area.
- Firm individual entitlements for each agency, with flexibility to trade water entitlements, and water, among BAWSCA agencies.
- Ability for BAWSCA to "wheel" water from outside sources during drought.

B. High Quality

- A commitment by San Francisco to deliver potable water requiring no additional treatment (except for Coastsides).
- Prompt notification of possible Safe Drinking Water Act violations or changes in water quality affecting individual customers.

C. Fair Price

- In general, agencies expressed desire to preserve the basic cost allocation architecture of the existing Master Contract:
 - Cost of water to be limited to facilities and services that benefit wholesale customers (i.e., no in-City costs, no Hetch Hetchy power costs, unless power revenues also shared.)
 - Costs of regional facilities allocated between San Francisco and wholesale customers on basis of relative usage.
 - Maintenance of the balancing account to monitor and account for overpayments/underpayments.
- Provide greater flexibility in administration to prevent sharp rate fluctuations from year to year.

The foregoing is an illustrative, rather than comprehensive, list of BAWSCA member goals. Moreover, it doesn't include any of the points that San Francisco may propose be incorporated into a new contract.

5. MECHANICS AND SCHEDULE

BAWSCA will negotiate on behalf of only those agencies that explicitly authorize it to do so. A sample resolution for your agency's governing body is attached which, if adopted, will provide this authorization. As you will see, it is a carefully crafted document, designed to be both sufficiently broad while also reserving full authority in your agency's governing body to withdraw that authority at any time and to make clear that the ultimate authority to enter into any agreement is reserved to your agency.

In terms of timing, a logical point at which to begin negotiations is shortly after the PEIR is released in draft form. This is expected to occur in November of this year. Ideally, it would be most helpful to receive all of the authorizations by the end of September.

If you, or any members of your governing board have any questions about this information or the accompanying resolution, please let Art Jensen know as soon as possible. He, and the entire BAWSCA team, are available to answer any questions you may have and to attend the meeting of your governing body at which the resolution will be considered.

RESOLUTION NO. _____

**RESOLUTION APPOINTING THE BAY AREA WATER SUPPLY
AND CONSERVATION AGENCY AS AUTHORIZED REPRESENTATIVE OF CITY
IN DISCUSSIONS/NEGOTIATIONS WITH SAN FRANCISCO FOR AN AGREEMENT TO PROVIDE
A RELIABLE SUPPLY OF HIGH QUALITY WATER AT A FAIR PRICE**

WHEREAS, in 1984 City, together with other water suppliers in Alameda, San Mateo and Santa Clara counties, entered into a "Settlement Agreement and Master Water Sales Contract" with the City and County of San Francisco (San Francisco). The 1984 Contract settled a federal lawsuit brought on behalf of City and other water suppliers to these communities challenging the legality of water rates charged by San Francisco; and

WHEREAS, the 1984 Contract and the individual water supply contract entered into concurrently by City and San Francisco will expire on June 30, 2009; and

WHEREAS, in April 2003, the City and other water suppliers in Alameda, San Mateo and Santa Clara counties established the Bay Area Water Supply and Conservation Agency (BAWSCA) as authorized by Water Code Section 81300 *et seq.* pursuant to State legislation enacted in 2002 (AB 2058). The City is represented on the BAWSCA board of directors; and

WHEREAS, BAWSCA has proposed to serve as the representative of its members in discussions and negotiations with San Francisco leading toward a continued, and improved, contractual relationship with San Francisco for delivery of drinking water after June 2009 and has provided funds for this activity in its budget for Fiscal Year 2006-07; and

WHEREAS, BAWSCA has the capabilities required to serve in this capacity by virtue of Agency staff and consultants in relevant disciplines including civil engineering, water supply planning, finance, economics, accounting, and law; and

WHEREAS, BAWSCA's General Manager has met with City's representatives to discuss their perspectives on a continued contractual relationship with San Francisco for water supply.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Milpitas as follows:

1. City appoints BAWSCA as its authorized representative in discussions and negotiations with San Francisco for the terms and conditions of delivery of drinking water after June 2009, to be incorporated in a new overall agreement between San Francisco and its regional customers.

2. BAWSCA, through its General Manager, shall confer with and keep the City informed on the status of these discussions and negotiations. To that end, the BAWSCA General Manager shall provide a report to City no less frequently than each calendar quarter, on developments during the preceding three months and expected activities during the ensuing three months.

3. This appointment shall continue unless and until revoked by the City Council.

4. This resolution confers no authority on BAWSCA to enter into a contract with San Francisco or to make any commitments legally binding on City. The authority to enter into any contracts is expressly reserved to the City Council.

PASSED AND ADOPTED this _____ day of _____, 2006, by the following vote.

AYES:

NOES:

ABSENT:

ABSTAIN:

ATTEST:

APPROVED:

Mary Lavelle, City Clerk

Jose S. Esteves, Mayor

APPROVED AS TO FORM:

Steven T. Mattas, City Attorney